OCT 23 1950

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 375

THOMAS M. STANBACK AND FRED J. STANBACK,
Petitioners,

vs.

CHARLES H. ROBERTSON, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF NORTH CAROLINA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT.

H. GARDNER HUDSON,
Counsel for Petitioners.

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vs.

CHARLES H. ROBERTSON, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF NORTH CAROLINA,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT.

Thomas M. Stanback and Fred J. Stanback pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, entered in the above entitled case on August 26, 1950.

Opinions Below

The judgment and proceedings in the District Court for the Middle District of North Carolina are not reported. The opinion of the Court of Appeals for the Fourth Circuit (R. 347) is reported in 183 F. 2d 889.

Jurisdiction

The judgment of the Court of Appeals was entered on August 26, 1950. The jurisdiction of this Court is invoked under Title 28, United States Code, section 1254.

Questions Presented and Specification of Errors to Be Urged

The questions presented arise out of the errors of the Court of Appeals

1. In holding that the earlier decisions of the Tax Court of the United States were not res judicata (a) as to the whole cause of action, or (b) as to ownership of partnership capital under the *Clifford* case, or (c) as to years prior to any change in the law.

2. In refusing to hold that Stanback Company was entitled to recognition for the year 1941 as a matter of law.

3. In holding that the petitioners were not entitled, upon the issue of their good faith, to show that their tax returns and the partnership returns for the years 1938 and 1939 were examined by the Commissioner of Internal Revenue in 1940 and 1941, respectively, and that the Commissioner recognized the partnership.

4. In holding that the District Court did not commit errors of law in essential respects in its charge to the jury as follows:

(a) In giving the determination of the Commissioner the quality of probative evidence in determining the preponderance of evidence.

(b) In defining "business purpose".

(c) In making an intent to avoid or reduce taxes an objective test of the validity of the partnership, in fact, in making it a negative statement of the issue.

Statutes and Regulations Involved

The pertinent statutory provisions are printed in Appendix A, infra, pp. 21-22.

Statement

These actions involve income taxes assessed against the petitioners for the year 1941 by reason of the reallocation of the income of a family partnership in which the petitioners were general partners and trustees of six trusts for their wives and children were limited partners. Judgment was rendered against the petitioners upon the verdict of a jury and the Court of Appeals affirmed.

In a previous attempt to reallocate the income from the same partnership for the years 1938 and 1939 the Tax Court of the United States had decided in favor of the petitioners, *sub nom. Wachovia Bank and Trust Company et al.* (R. 318-332), Dock. 1899-1902, 1944 P-H T. C. Memo. Dec. 44,217.

The facts relating to the creation of the trusts and the organization of the partnership were found in detail by the Tax Court of the United States in the earlier cases (R. 319-332). The facts as stated here constitute a bare outline of the evidence in the District Court.

The petitioners first formed a partnership in 1924 with small capital, Thomas M. Stanback reserving a royality of 2% of gross sales for formulae, trade-marks and good will. Thomas M. Stanback was in charge of manufacturing and advertising and Fred J. Stanback handled sales. (R. 22, 24-25, 50, 74-75).

By 1937 the business had about forty employees in manufacturing, eight in the office, and thirty to thirty-five salesmen. The products of the partnership were being sold in approximately thirty-five states (R. 138, 29, 59, 81).

Prior to 1937 the brothers had considered making gifts to their families. After consultation with business friends,

their banker, an officer of the trust department of their bank and a lawyer recommended by him, the plan which was carried into effect was evolved. (R. 26-30, 77-84).

The petitioners had several motives:

1. To provide for their families by means of gifts. (R. 28, 77, 84, 104).

2. They hoped to interest their sons in the business. (R. 67, 79).

3. The high mortality of similar businesses. (R. 81-83).

4. Income tax savings. (R. 62-81).

5. Legal difficulties in handling real estate and listed securities in a partnership. (R. 79).

The business had a net worth at book value (not including trade-marks, formulae and good will) of $285,223.97. (R. 244-245). The reorganization was accomplished by the following transactions in the order stated:

1. A North Carolina corporation, Stanco Realty Company, was organized by the petitioners and their wives. The partnership then transferred to this corporation land and securities of a value of $156,768.17 in exchange for 600 shares of its stock to each of the petitioners. (R. 43, 253).

2. Each petitioner then transferred to the other petitioner and Wachovia Bank and Trust Company as trustees of each trust a 4% undivided interest in the remaining property and assets of the partnership. (R. 40, 224, 240, 243).

3. The assets of the old partnership were then contributed as the capital of a new limited partnership with a capital of $125,000.00 in which the petitioners owned 38%

each and the trustees of each trust 4%. Thomas M. Stanback reserved a royalty of 2% of gross sales.

4. Each petitioner transferred to each trust created by him 25 shares of the stock of the Stanco Realty Company. (R. 42).

Each petitioner had then transferred to the trusts 12½% of his holdings in Stanco Realty Company and 24% of his interest in the remaining assets of the partnership. All of these transactions were conducted in strict conformity with the laws of North Carolina.

Choice of the forms of organization was determined as follows:

1. The real estate and securities were transferred to a corporation because that business could be transacted wholly within the State of North Carolina. (R. 79, 105).

2. The medicine business was continued as a partnership because of an estimated annual cost of not less than $25,000.00 for keeping records and paying corporation taxes in thirty-five states, which would increase if the business expanded into other states. (R. 109, 78, 30, 29).

3. Because of legal difficulties the petitioners were advised not to make outright gifts of corporate stock or partnership interests to minors, but to make irrevocable gifts in trust. (R. 31, 77-78, 108).

4. A limited partnership was organized because the corporate trustee, under the advice of its counsel, would act only as a limited partner. (R. 109-110).

One of the trust agreements (R. 321-330) and the partnership agreement (R. 201-243) are in the record. They are outlined here.

The trust for each wife provides for the payment of the income to her annually upon her demand for her life so long as she did not institute or prosecute a suit against the grantor for divorce or separation. There is no restraint upon remarriage after the grantor's death. At the death of the wife the funds in her trust will augment the trusts for the children and their issue. (R. 228).

The trusts for each child provide for the payment of income for the child's benefit during minority. At age 21 all of the income is payable quarterly. At ages 25, 30 and 35 distributions of principal are provided for, with power in the Trustees to withhold distribution if the child has shown incapacity for conservation and management of the property. (R. 229-232). No distributions of principal are to be made prior to December 31, 1949, the date of the termination of the new limited partnership. (R. 230). Provision is made for the allocation of a share to any after-born child, born before December 31, 1949 by re-allocation of the trust shares only. (R. 221, 227). There are gifts over to issue, and there are cross remainders between the several trusts. There is a power of invasion of principal in emergencies, and all the trusts must terminate within the period of the rule against perpetuities. (R. 232-234). The trusts are irrevocable. (R. 234).

The powers given to the Trustees are the usual powers given in such cases. The Trustees are not prohibited from disposing of any of the trust property, nor are they required to sell it to the grantors or to any other person. (R. 224-227). The corporate Trustee cannot resign during the life of the grantor except with his consent, nor after his death without the consent of the Court. (R. 235). The individual Trustees are entitled to no compensation. The compensation of the corporate Trustee is prescribed. (R. 235, 236).

The partnership agreement prescribes the rights and duties of all partners. It is a businesslike document with normal and usual provisions for the protection of the rights of all of the parties. The general partners are given a drawing account of $1,500.00 per month each, payable in all events, out of either income or capital, for their services, but chargeable against their shares of the profits if the profits exceed that amount. The same basic amount is payable to the surviving partner during the period of liquidation required if the partnership is terminated by the death or the incapacity of a general partner. (R. 219, 209). The partnership is terminated by the death or incapacity of a general partner and in any event on December 31, 1949. (R. 202, 215). The general partners have the right to set aside profits for specific business purposes, but subject to that fiduciary power all profits must be determined and distributed annually. (R. 207-310). With the exception of the years 1938 and 1939 when a part of the profits were withheld for advertising and promotion, all of the profits of this partnership have been actually distributed in the year following the year in which they were earned. (R. 121, 127-129). Any dispute between any of the partners or the representatives of a partner with respect to the construction or application of the partnership agreement or the operations thereunder are subject to arbitration without any qualifying condition. (R. 222).

The sons of the petitioners worked in the business during vacations. All of them took business courses in college. Both sons of Thomas M. Stanback were in the armed services. The older worked for about two years in the business and then became a member of the faculty of the School of Business at the University of North Carolina. The other commenced working in the business and is still there. The son of Fred J. Stanback will enter the business as soon as he graduates from college. (R. 67-68, 79, 155).

All of the parties to the transactions outlined have complied scrupulously with their agreements. In its opinion in the 1944 cases the Tax Court of the United States said (R. 334-335):

"The terms of the instant trust agreements suggest a complete divestment by petitioners of command over the entrusted property and the income arising therefrom. The petitioners were not trustees under their own trusts, they reserved no power of alteration or revocation, they could receive no part of the trust income, there was no reversion of the corpus to them, they could not substitute other property for that transferred to the trustees, and they could not direct the investment of corpus and income. The corporate co-trustee, the Bank, was disinterested and subject to no domination by the petitioners. It could not be replaced except upon its own act of resignation and after petitioners' death, even this was conditional. Moreover, the evidence indicates that it was the Bank which assumed the active burden of administering the trusts. It kept detailed records and, in the final analysis, determined the investments which should be made with undistributed trust income. It was paid a commission for its services."

The petitioners each made further gifts of 2% to each of the trusts at the end of 1938. (R. 240, 243). These transfers left each general partner owning 32% and each trust 6% of the partnership capital.

Gift tax returns were filed and gift taxes paid. (R. 243).

None of the partnership income has been used to pay family expenses or to discharge any legal obligation of the grantors. (R. 66-67). When Thomas M. Stanback, Jr., became twenty-one years old he had and exercised control over the income of his trust. (R. 152-153).

After the decision in *Helvering* v. *Stuart*, 317 U. S. 154 the Commissioner reopened the returns for 1938 and 1939.

This resulted in the decisions in the Tax Court of the United States. (R. 343, 344). After the decision in the *Tower* case the Commissioner invoked the five year statute of limitations and assessed the taxes for the year 1941 which are in issue in this case.

The Court of Appeals affirmed the judgment of the District Court without discussing all of the errors assigned. The statement of questions involved in the Court of Appeals, which were debated on both sides, is printed as an appendix to this petition. Appendix B, pp. 23-24). Certified copies of all briefs have been filed with the Clerk.

Reasons for Granting the Writ

1. Res Judicata

(a) *As to the whole cause of action.*

The rule of collateral estoppel requires that the issue, the facts and the applicable law be the same. *Commissioner* v. *Sunnen,* 333 U. S. 591. It has not been denied that the essential facts are substantially the same. The Court of Appeals held that the issue was not the same but that, if the issue was the same, there had been an intervening change in the law. (R. 354).

It is submitted that its decision is in conflict with the following decisions:

Willingham v. *Home Oil Mill,* 181 F. 2d 9 (C. A. 5), now pending upon petition for certiorari, No. 257 filed 8-21-50;

Commissioner v. *Texas-Empire Pipe Line Co.,* 176 F. 2d 523 (C. A. 10);

United States v. *Archer,* 174 F. 2d 353 (C. A. 5);

Mercantile-Commerce Bank & Trust Company v. *Commissioner,* 165 F. 2d 307 (C. C. A. 8);

Cory v. *Commissioner,* 159 F. 2d 391 (C. C. A. 3);

Sidney M. Harvey, Doc. 1056, 1944 P-H T. C. Mem. Dec. 44,309;

Carl G. Dreymann, Doc. 22277, 1950 P-H T. C. Mem. Dec. 50,045;

Chandler Laboratories, Inc. v. *Smith,* 88 F. Supp. 583 (D. C. E. D. Pa.).

Apparently, the government asserts the plea as frequently as taxpayers. It did so in the *Archer, Mercantile-Commerce Bank & Trust Company* and *Cory* cases, cited above. See *Trapp* v. *Jones,* 87 F. Supp. 415 (D. C. Okla.).

The *Mercantile-Commerce Bank & Trust Company* and *Cory* cases involved the taxability of income of certain trusts to the grantor under the doctrine of the *Clifford* case. *Sidney M. Harvey, supra,* applied the rule to a family partnership case.

The Court of Appeals held that the *Clifford* doctrine involves only the elements of control and duration of a trust, while the issue here was the bona fide intent of the partners to join in the conduct of the partnership business, control being only one of the factors to be considered in making that determination. (R. 353-354).

The error in this position is that the *Clifford-Horst* doctrine deals with the "reality" of the arrangement. Both the 1944 cases and this case dealt with the partnership income, all of the facts including the partnership and trust transactions were considered, and it was held that the entire arrangement did not lack reality. An examination of the evidence and the briefs in the two cases will establish that the same facts which were urged to show lack of control in 1944 are urged to show lack of intent in 1949. Moreover, all of the leading cases involving the *Clifford-Horst*

doctrine had been decided in 1944, and the *Tower* and *Lusthaus* cases had been decided by the Tax Court.[1]

If the Court of Appeals is right, the government simply has two chances in all cases involving trusts as members of a partnership, while the taxpayer has only one. The government may make the first attack under the *Clifford* rule, upon the ground that the grantor has retained "control." If it loses, it may then attack the partnership upon the ground that the same evidence proves lack of "intent." If the taxpayer loses on either issue, his liability is fixed, but to win he must succeed on both issues. This anomalous result will be reached under the same section of the statute and under a line of cases which are said to establish a single rule.

The government failed to establish its claim in 1944 upon a consideration of the whole "bundle of rights." It is submitted that it should not be permitted to break the bundle now by taking one stick at a time. The issue in any case is the good faith of the parties and the reality of the transactions, and the 1944 decisions established both.

(b) *As to ownership of partnership capital*

In *Commissioner* v. *Culbertson*, 337 U. S. 733 at page 748 this Court said:

> "The cause must therefore be remanded to the Tax Court for a decision as to which, if any, of the respond-

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[1] *Lucas* v. *Earl*, 281 U. S. 111, *Burnet* v. *Leininger*, 285 U. S. 136, *Helvering* v. *Clifford*, 309 U. S. 331, *Helvering* v. *Horst*, 311 U. S. 112, *Helvering* v. *Eubank*, 311 U. S. 122, *Harrison* v. *Schaffner*, 312 U. S. 579, *Francis E. Tower*, 3 T. C. 396, and *A. L. Lusthaus*, 3 T. C. 730.

The government recognizes that the *Tower* and *Lusthaus* cases are merely applications of that doctrine. See page 10 of the Commissioner's brief on petition for certiorari in *Wilson* v. *Commissioner*, certiorari denied, 332 U. S. 769, and page 9 of the petition in *Commissioner* v. *Culbertson*, certiorari granted, 335 U. S. 883.

> ent's sons were partners with him in the operation of the ranch during 1940 and 1941. As to which of them, in other words, was there a bona fide intent that they be partners in the conduct of the cattle business, either because of services to be performed during those years, or because of contributions of capital of which they were the true owners, as we have defined that term in the *Clifford, Horst,* and *Tower* cases."

In 1944 the Tax Court determined that the Trustees were the true owners of the partnership capital as that term was defined in the *Clifford* case. Even the Court of Appeals concedes that point. It is submitted that that forecloses further inquiry into that subject. The interests of the Trustees were capital interests in a business in which substantial capital was the material factor.[2] Since the Trustees were the true owners of that capital under the *Clifford* case and actually received the income from it, that income was not taxable income to the petitioners.

The Court of Appeals also concedes that the presence or absence of control as defined in the *Clifford* case is at least one of the elements to be considered in determining intent to do business as partners. (R. 354). Since this point was determined in the earlier cases and was conclusive at least to that limited extent, it was gross error for the trial court to exclude the determinations of the Tax Court from consideration by the jury. Certainly, the true ownership of the partnership capital under the *Clifford* case is a fact which must be considered in determining whether intent existed. In view of the large number of cases involving trusts which are already reported, and

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[2] In 1941 capital and surplus invested in the business amounted to more than $256,000.00, (R. 127), and the expenses of the business amounted to nearly $575,000 (R. 255).

others which are pending, it is submitted that this point is of sufficient importance to require review and determination by this Court.

(c) *Limitation of Change in Judicial Climate to Events Occurring After the Change*

The partnership involved in this case was organized in 1937. This was nearly three years before the *Clifford* case was decided and nearly nine years before the *Tower* and *Lusthaus* cases were decided. The Court of Appeals held that, if the issue involved was the same, the applicable law had been changed by judicial decision. If this is correct, in view of the manner in which the criteria of taxation have been developed, it is submitted that the Court should consider the applicability of the doctrine of *Helvering* v. *Reynolds,* 313 U. S. 428, even if it involves overruling some of the Court's decisions.

The Court of Appeals does not fix the date of the change in judicial climate. If the *Tower* and *Lusthaus* cases in 1946 do not mark the date of the change, it is submitted that no change has occurred. See footnote 1, page 12 of this petition.

The petitioners organized this partnership in accordance with the law as it was then understood. It was not attacked for five years. After it withstood attack at that time, it was not attacked again until ten years after it was organized. The assessments and interest through the years still open will bankrupt them.

2. Recognition of the Partnership as a Matter of Law

It is submitted that the decision of the Court of Appeals is in conflict with the decision of this Court in *Commissioner*

v. *Culbertson,* 337 U. S. 733 and with the following decisions of other Courts of Appeals:

Thompson v. *Riggs,* 175 F. 2d 81 (CA 8);
Greenberger v. *Commissioner,* 177 F. 2d 990 (CA 7);
Maiatico v. *Commissioner,* 183 F. 2d 836;
Wenig v. *Commissioner,* 177 F. 2d 62 (CA D. C.);
Johnston v. *Commissioner,* 180 F. 2d 355 (CA 6).

Obviously, no two cases will be exactly alike. Therefore, whether there is a conflict of decision must be determined by general attitudes and statements and by facts selected for emphasis and facts completely ignored in arriving at a decision.[3]

In the *Greenberger* case, *supra,* the income of the business consisted entirely of commissions on sales of steel products, the taxpayer making a large volume of sales in person. The capital of the business was only $10,000.00. Tax saving was one of the motives for the formation of the partnership. Nevertheless, the Court of Appeals held that there was no substantial evidence for disallowance. In the *Thompson* case, *supra,* the taxpayer gave away 50% of his interest in the business. He was a trustee of the trusts. Both by the

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[3] Compare the decisions of the Tax Court in *Milton Greenberger,* Dock. 13446, 1948 P-H T. C. Memo. Dec. 48,102, *Jerry Maiatico,* 12 T. C. 146, *Irving Wenig,* Dock. 9857, 1947 P-H T. C. Memo Dec. 47,338. All of these cases were reversed by the Courts of Appeals in the cases cited above upon the ground that there was no substantial evidence to support the Tax Court's determination.

Compare also the decisions of the Court of Appeals for the Fourth Circuit in *Funai* v. *Commissioner,* 181 F. 2d 890, with the decision of the Tax Court in *H. V. Funai,* 13 T. C. 696. In the *Funai* case the wife got none of the profits, but she had the right to draw on most of the bank accounts. This was said to give her control of the income, 181 F. 2d, at 894. The exclusive control of the income in the *Stanback* cases was ignored. In the *Funai* case the acceptance of the partnership returns by the Commissioner is a reason for reversing the Tax Court, 181 F. 2d 895. In the *Stanback* cases the taxpayers were deprived of the right to make that fact known to the jury.

terms of the trust agreements and the partnership agreements, a corporate trustee was excluded from management and control. The taxpayer reserved the right to make final decisions in all disagreements relating to the partnership. The partnership continued after the death of a partner. See Regulations 111, section 29.3797-4. No partner could sell his interest without the consent of all. The distribution of the profits was negligible. On all of these points the facts in the *Stanback* cases are more favorable to the taxpayer, yet the *Riggs* partnership was sustained.

The decision of this Court in the *Culbertson* case, instead of decreasing litigation, has apparently increased it. 1950 Prentice-Hall Federal Tax Service, Paragraphs 15,508-15,509 lists approximately 359 reported cases involving family partnerships, 139 before *Tower,* and 220 between *Tower* and *Culbertson.* There have been 107 since *Culbertson.* The cases are now being reported at the rate of approximately three per week. It is believed that the tabulation is by no means complete.

It is submitted that the Court should grant review in this case for the purpose of clarifying the criteria of intent, or that it should otherwise reexamine the entire situation for the purpose of producing some uniformity of decision. Courts whose views were slanted toward those of the Commissioner under the misinterpretation of the *Tower* rule, are merely changing the language of original capital, vital services and business purpose into the language of intent, and are reaching substantially the same results that were reached before. In the final analysis these are rulings of law and not findings of fact. Moreover, the liability of a taxpayer should not be determined by the accident of the District or Circuit in which he resides, nor by his inability to pay the tax and sue for refund so that he is forced to try his case in the Tax Court. In at least one case the Tax

Court seems to have been influenced by the decisions of a particular circuit in which a case would have been heard or reviewed. *Willis H. Vance,* 14 T. C. # 132 (6-15-50). In *Hanson* v. *Birmingham* (not reported) 1950 P-H Par. 72,681 (D. C. Ia.) the Court actually held that neither a trustee nor a trust can be a partner under any circumstances. In a year involving a loss the Commissioner has actually asserted the validity of a family partnership. *J. M. Tindall,* 14 T. C. # 125, (6-9-50). These are only illustrations of the confusion existing.[4]

There has been no change in the statutes on this subject nor in the regulations defining partnerships since about 1932. No regulations have been issued in which any attempt has been made to state or to define the requirements for a valid partnership as insisted upon by the Treasury or approved by the courts.[5] Reported decisions include five periods of varying interpretations of law and fact: (1) Those prior to 1943, (2) Those between 1943 and the *Tower* case in 1946, (3) Those between 1946 and the abrogation of the Dobson rule in 1948, (4) Those between 1948 and the decision in the *Culbertson* case, and (5) Those decided since the *Culbertson* case. Notwithstanding the differences exist-

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[4] Senate Finance Committee Report #2375, 8-22-50, CCH Standard Federal Tax Reports, Volume XXXVI, #39, 9-6-50, Part 1, p. 60, which states that it is delaying settlement of cases in the field.

This Court in the *Culbertson* case cited the rules relating to transfers in contemplation of death as an analogy. The Treasury regards intent as an unsatisfactory test, and has asked Congress to amend the law. See statement of Secretary Snyder to the House Ways and Means Committee, and the report of the House Ways and Means Committee on the Revenue Act of 1950. See CCH Federal Estate and Gift Tax Reports, #28, Part 1, p. 10, and CCH Standard Federal Tax Reports, Volume XXXVI #30, Part 1, p. 62.

See also 17, The University of Chicago Law Review, 503 at p. 511.

[5] Mertens—Law of Federal Income Taxation, Section 35.02. There has been a statement of policy, (I.T. 3845, 1947—2 C. B., 66), but that has not been followed.

ing in these periods the courts are continuing to cite and to follow cases decided throughout all of them so long as they support the result to be arrived at. The confusion predicted by Mr. Justice Rutledge in his concurring opinion in the *Tower* case, 327 U. S. at page 292, has come to pass.

It is respectfully submitted that this situation cannot be explained as a normal variation in findings of fact, and that a review and restatement by this Court of the applicable principles is absolutely necessary for the uniform and fair administration of the tax laws upon this subject.

3. Recognition of the Partnership by the Commissioner of Internal Revenue as Evidence of Good Faith

The trial court refused to permit the petitioners to show that during the years 1940 and 1941 the Commissioner of Internal Revenue examined their returns and the partnership returns and recognized the partnership. The year 1940 preceded the year in question, and one of the reports was made to them during 1941.

We shall not labor this point. Similar evidence has been admitted at the suggestion of the trial court. *Thompson* v. *Riggs*, 175 F. 2d 81, at 86. In *Funai* v. *Commissioner*, 181 F. 2d 890, at 895, even the Court of Appeals for the Fourth Circuit uses the acceptance of partnership returns by the Commissioner as a reason for reversing the Tax Court.

The offer of evidence was strictly limited to the issue of good faith. It was not offered as an estoppel. The Court was asked to charge the jury that it constituted no estoppel against the government (R. 47-49, 156-157, 15-17). It is submitted that it was clearly competent.

4. Errors in the Charge to the Jury

(a) *The Effect Given to the Determination by the Commissioner*

The trial court charged the jury, at the request of the respondent (R. 183), (1) that it is presumed that the Commissioner acted on evidence which would justify a fair minded person that the assessment should have been made, (2) that the evidence on which he acted need not be shown to the jury and (3) that the jury could not disregard the assessment unless it was convinced that the Commissioner acted unjustly on the basis of evidence before him.

The respondent contended that this charge is supported by *United States* v. *Rindskopf*, 105 U. S. 418. While the charge given here was given by the trial court in that case, the question here at issue was not considered by the Supreme Court.

The effect of the charge was to give the determination of the Commissioner the status of evidence in determining the preponderance of the evidence. This was erroneous and contrary to the following decisions:

A. & A. Tool and Supply Company v. *Commissioner*, 182 F. 2d 300 (CA 10);

Hemphill Schools, Inc. v. *Commissioner*, 137 F. 2d 961 (C. A. 9);

Redfield v. *Eaton*, 53 F. 2d 693 (D. C. Conn.);

Overland Cement Plaster Co. v. *Reynolds*, 17 A. F. T. R. 1091 (D. C. Wyo).

(b) *The Definition of Business Purpose*

In a number of instances the Court charged the jury that business purpose is a necessary element of a valid partnership. (R. 186, 187, 188). Business purpose was defined in these words (R. 186):

> "When I speak of 'business purpose' I mean whether any purpose for the benefit of the business itself was

served by the formation of the alleged partnership."

In one aspect this is another statement of the "test" of original capital, expressly rejected by the *Culbertson* case.

The definition is also directly contrary to the decision of the Court of Appeals for the Sixth Circuit in *Miller* v. *Commissioner*, 183 F. 2d 246, at 254 where the Court, reversing the Tax Court, said:

> "The test, of course, is not whether there is a need or obligation on the part of a businessman to make his wife and children partners in his business, or whether any benefit results to the business. Again, these are only circumstances to take into consideration in ascertaining intention."

(c) *Making Intent to Avoid or Reduce Taxes an Objective Test of the Validity of the Partnership or in Making It a Negative Statement of the Issue*

The petitioners in these cases did not deny that one of their motives was the reduction of their income taxes. At the same time they testified that they had other motives and the evidence upon that subject was not impeached.

Even in the *Tower* case a motive to reduce taxes was given the status of evidence only, and the subject is mentioned in the *Culbertson* case only in a footnote, 337 U. S., at 744, in which the Court said:

> "that existence of a tax avoidance motive gave some indication that there was no bona fide intent to carry on business as a partnership."

In no less than eleven places in the charge the Court told the jury that the question submitted to it was whether or not the parties entered into a bona fide partnership arrangement or whether it was a mere device to split income and

reduce taxes. (R. 161, 162, 167, 168, 170, 191, 198 and 200). The same statement is made twice on pp. 168, 170 and 198. In addition, the Court took two pages (R. 162-164), to explain to the jury the method of making a partnership return, how the formation of a partnership could be availed of to split income and the effect of the splitting of income on the applicable surtax rates. Again two more pages are consumed (R. 169-170), in a repetition of the same idea, using the actual figures for the year 1941, and the subject is introduced with the Court's admonition that "This is a matter of very great importance." (R. top of p. 169). At R. 168 the jury was told that there could not be any intent to "evade" taxes, if there were no taxes, but that they should take into consideration the fact that the figures were "somewhat staggering to a man of common means."

A motive to save taxes was made an objective test of validity. In fact, the emphasis upon it made it the sole test.

Conclusion

For the foregoing reasons, this petition for a writ of certiorari should be granted.

H. Gardner Hudson,
Counsel for Petitioners.

APPENDIX A

Internal Revenue Code:

Sec. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of what ever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. • • •

Sec. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

Sec. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

• • • • • • •

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

Sec. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

• • • • • • •

(2) Partnership and Partner.—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * * * *

REGULATIONS 103:

Sec. 19.3797-5. LIMITED PARTNERSHIPS.—

A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership, notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of that Act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

APPENDIX B

Excerpts from Pages 2-5 of Brief of the Partners in the Court of Appeals

QUESTIONS INVOLVED

1. Whether the prior decisions of The Tax Court of the United States involving the same taxpayers and the income of the same partnership were res judicata in the sense of collateral estoppel.

Raised in Paragraphs 7 (d), (e) and (f) (App. pp. 5 and 12) of the complaints of both of the plaintiffs, by an issue tendered by the plaintiffs, (App. p. 15) by offer of proof of the record in The Tax Court of the United States and motion for directed verdict (App. pp. 142-144 and App. p. 158), and by motion for judgment notwithstanding the verdict (App. p. 19).

2. Whether the plaintiffs were entitled to recover upon the ground that the partnership was entitled to recognition during the calendar year 1941 as a matter of law.

Raised by motion for directed verdict (App. p. 158) and by a motion for judgment notwithstanding the verdict (App. p. 19).

3. Whether the Court erred in refusing to set aside the verdict on the ground that the verdict was contrary to the greater weight of the evidence.

Raised by motion (App. p. 19).

4. Whether the record of the proceedings in The Tax Court of the United States was admissible in evidence for the purpose of enabling the jury to arrive at its verdict on the main issue.

Raised by alternative offer of proof (App. pp. 144 and 145), and by special request for instructions No. 19 (App. p. 17).

5. Whether the Court erred in excluding from the evidence reports of audit by the Commissioner of Internal

Revenue issued to the plaintiffs and the partnership in 1940 and 1941 making no reallocation of partnership income, offered for the limited purpose of showing good faith on the part of the plaintiffs.

Raised by offer of proof (App. pp. 47-49, 156-157), and by requests for instructions Nos. 17 and 19 (App. pp. 15-17).

6. Whether the form of the issue and the charge of the Court were in accordance with the law as declared by the Supreme Court of the United States in *Commissioner* v. *Culbertson,* the following being instances in which the plaintiffs contend that departure was made from the decision of the Supreme Court in that case:

(a) Error as to the effect to be given to the determination of the Commissioner of Internal Revenue.

Raised by the granting of defendant's request No. 2 (App. pp. 183-184) and exceptions thereto (App. p. 194).

(b) Error in the definition of business purpose and the application thereof.

Raised by the granting of defendant's requests Nos. 8 (App. p. 186), 7 (App. p. 186), 10 (App. p. 187), and 13 (App. p. 188), and exceptions thereto (App. pp. 194-196).

* * * * * * *

(f) Error in making intent to avoid or reduce taxes an objective test of the validity of the partnership.

Raised b ythe granting of defendant's requests Nos. 6 (App. p. 185), 11 (App. p. 187), 12 (App. p. 187), 14 (8) (App. pp. 188-189), and 15 (App. p. 189), and exceptions thereto (App. p. 194-196).

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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 375

THOMAS M. STANBACK AND FRED J. STANBACK,
Petitioners

v.

CHARLES H. ROBERTSON, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF NORTH CAROLINA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The District Court rendered no opinion. The opinion of the Court of Appeals (R. 347-354) is reported at 183 F. 2d 889.

JURISDICTION

The judgment of the Court of Appeals, affirming the judgment of the District Court entered on

the verdict of the jury (R. 20-21), was entered on July 26, 1950 (R. 355). The petition for a writ of certiorari was filed on October 23, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

In 1937, petitioners made gifts of portions of their interests in an existing partnership in trust for the benefit of their respective wives and children, making themselves and a bank co-trustees, and then immediately entered into a new partnership arrangement with the trustees of those trusts whereby the trustees purported to become limited partners of the otherwise general partnership to the extent of the gifts. Petitioners thereafter paid their income taxes on the basis of their reduced interests in the partnership, and the Commissioner, for the year 1941, charged the income of the trusts back to petitioners, respectively, on the ground that the partnership had not been entered into with bona fide intent so far as the trustees purported to have become members thereof. Petitioners then sued to recover the additional taxes assessed and collected. The questions presented are:

1. Whether it was proper for the trial court to submit to the jury all factual considerations relevant to the question whether the trustees were, during the year 1941, bona fide partners of petitioners within the meaning of the federal in-

come tax laws, or whether the trial court was required to hold the trustees bona fide partners as a matter of law.

2. Whether, under the doctrine of collateral estoppel by judgment, two decisions of the Tax Court, which had overruled the Commissioner's determinations of deficiencies in petitioners' income taxes for the years 1938 and 1939, foreclosed inquiry, for 1941 income tax purposes, into the validity of the partnership purportedly entered into between petitioners and the trustees.

3. Whether the trial court erred in excluding from the evidence certain letters written by the Internal Revenue Agent in Charge concerning petitioners' 1938 and 1939 income taxes.

4. Whether the trial court committed reversible error in its charge to the jury.

STATUTE INVOLVED

Internal Revenue Code:

> Sec. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from

interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * *

(26 U. S. C. 1946 ed., Sec. 22.)

Sec. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1946 ed., Sec. 181.)

Sec. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U. S. C. 1946 ed., Sec. 182.)

STATEMENT

Petitioners, Thomas M. Stanback and Fred J. Stanback, instituted civil actions in the United States District Court for the Middle District of North Carolina against the respondent, the Collector of Internal Revenue for the District of North Carolina, to recover income taxes alleged to have been erroneously collected from them for the taxable year 1941, petitioner Thomas M. Stanback seeking a refund in the sum of $63,380.46 and petitioner Fred J. Stanback a refund in the sum of $62,756.37 (R. 1-14). The cases were consolidated for trial and were tried to a jury (R. 21). The jury rendered a verdict in favor of respondent, and judgment dismissing the actions was entered thereon by the District Court (R. 20-21). On appeal, the District Court's judgment was affirmed (R. 355).

The evidence, which consists of testimony, stipulations, and various exhibits, may be summarized as follows:

In 1924, petitioners, who are brothers, formed, by oral agreement, a partnership, which operated under the name of the Stanback Medicine Company, for the purpose of manufacturing and selling a proprietary medicine known as Stanback Headache Powders[1] (R. 22-24). A written partnership agreement was first drawn up in 1928 (R.

---

[1] The company also distributed a product referred to as "liver powders or liver fixers" (R. 37, 207).

22), and in 1931 the name of the partnership was shortened to Stanback Company (R. 24). At the time the partnership was formed the volume of business was very small, amounting to approximately $1000 a year (R. 24-26, 50). Thereafter, the annual volume of business and the income of the partnership increased rapidly. By 1935 the volume of business had increased to as much as $100,000 (R. 51), and by 1937 it had reached even a much larger amount (R. 52). By 1934, the volume of business was such that federal income taxes had become a rather large sum (R. 52), and by 1937, the partnership had accumulated a substantial surplus (R. 97, 105) which was invested in real estate and securities (R. 28). In 1941, the tax year here in question, the volume of business was $1,136,470.69 (R. 52) and the net income of the partnership was $404,199.80 (R. 53).

In 1937, after conferences with bank officials and an attorney, the petitioners entered into a new partnership arrangement (R. 35-37, 99-100, 105-107, 201-223). The first step in the formation of the new partnership was the organization of a corporation called the Stanco Realty Company (R. 33, 41). The petitioners transferred to this corporation substantially all of the investment assets of the old partnership in exchange for the capital stock of the corporation (R. 33). The next step in the new arrangement was the making by petitioners of substantial gifts in trust to their wives

and children.[2] Thomas established three trusts, one for his wife and one for each of his two minor children (R. 40, 224-237). The Wachovia Bank & Trust Company and his brother Fred were made co-trustees (R. 39-40, 224, 237). Thomas then transferred to each trust 25 shares of stock in the corporation and a 4 per cent interest in the old partnership (R. 40, 238-242). Fred in like manner established three trusts, one for his wife and one for each of his two minor children, made his brother Thomas and the Wachovia Bank & Trust Company co-trustees, and transferred interests during 1937 to each of the three trusts created by him equivalent to the interests transferred by his brother Thomas (R. 40, 238-243).

A new partnership agreement, dated December 29, 1937 (R. 35-36, 201-223) was entered into, which provided that the petitioners were to be general partners while the trustees of the six trusts were to become limited partners (R. 203). The agreement further provided that the general partners were to have complete control and management of the partnership business, its property and assets, together with the right to determine how the surplus funds of the business should be invested, while the limited partners were to have no voice whatever in the operation of the partnership (R. 211-212). The general partners were entitled,

[2] It was stipulated that petitioners paid gift taxes on the gifts made by them to their wives and children (R. 243).

under the agreement, to a drawing account of $1,500 per month, which was to be charged first against their share of the profits (R. 209). The general partners were given exclusive authority to determine what portion of the annual profits should be retained as necessary to the business and not distributed to the partners (R. 212). In 1938 petitioners each transferred an additional 2 per cent interest in the new partnership to the trusts (R. 44), so that finally, under the new partnership arrangement, petitioners each had 32 per cent ownership in the partnership business, and the trustees in the aggregate had a 36 per cent interest therein (R. 203, 240-242, 243). Prior to the establishment of the new partnership, petitioners had been advised by experienced tax counsel (R. 106) that under the new arrangement there would be savings in their federal income taxes (R. 32, 62, 100). Petitioners continued to run and manage the business after 1937 (R. 58), and no contention was made that the bank (R. 116) or the beneficiaries actually contributed any services in the operation of the partnership business (R. 191).

In 1941, each of the petitioners reported 32 per cent of the profits of the partnership business as income to him (R. 4, 11-12, 71, 101). Thomas Stanback had received an additional amount consisting of royalties of 2 per cent of the gross sales for formulae, trade-marks and good will, as provided in the partnership agreement (R. 207). Additional income taxes for the year 1941, in the

amounts of $63,380.46 and $62,756.37, including interest, were assessed against petitioners Thomas M. and Fred J. Stanback, respectively, by the Commissioner upon the theory that the partnership agreement of 1937 was invalid for tax purposes and that each petitioner should have reported 50 per cent of the net profits of the partnership as income to him (R. 3-4, 10-11).

ARGUMENT

1. Petitioners contend (Pet. 13-17), although their position is not entirely clear, that the decision of the court below is in conflict with this Court's decision in *Commissioner* v. *Culbertson,* 337 U. S. 733, seemingly on the hypothesis that the *Culbertson* decision requires that the validity of their family partnership must be recognized as a matter of law (Pet. 2). In this connection they assert that determinations concerning original capital, vital services, and business purposes as criteria for ascertaining the intent of the parties in creating family partnerships, are rulings of law and not findings of fact.

But in *Commissioner* v. *Culbertson,* 337 U. S. 733, 742, this Court explained that the question was "whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the

purposes for which it is used, and any other facts throwing light on their true intent—the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise."

Since this Court concluded, in *Culbertson* (337 U.S. at 743), that "There is nothing new or particularly difficult about such a test. Triers of fact are constantly called upon to determine the intent with which a person acted", there is no merit in petitioners' contention that the weighing of the various factual elements that may enter into a determination of the bona fide intent of the parties in entering into a partnership agreement involves determinations of law. Consequently, it was proper for the trial court to submit to the jury the entire issue as to whether the partnership was bona fide with respect to the trustees. And there can be no doubt that the wealth of evidence adduced in this case with respect to the establishment and operation of the business, the rapid rise of the income coupled with the tax consciousness of petitioners, the relationship of petitioners to the donees of their gifts, petitioners' status as co-trustees, the actual control of the business by petitioners after the new partnership was formed, the origin of the capital contributions, and the respective ability of the parties, constituted a factual basis from which the jury could reasonably infer that the partnership was not bona fide so far as the membership of the trustees was concerned.

2. Another contention made by petitioners (Pet. 9-13) is that two prior decisions of the Tax Court (See Exhibit 31, R. 257, 318-342), involving their income tax liabilities for the tax years 1938 and 1939, foreclose inquiry into the validity of the 1937 partnership under the doctrine of collateral estoppel by judgment.

The Tax Court decisions relied upon by petitioners were rendered on August 26, 1944 (R. 343, 344) and prior to this Court's decisions in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293. The Tax Court did not, in its decisions, consider the validity of the partnership or ground its holdings on the bona fide intent of the parties who purportedly had composed it and continued it in operation. Its rulings were based solely and squarely on the doctrine enunciated by this Court in *Helvering* v. *Clifford,* 309 U. S. 331, 337, which taxes a grantor on the income of a trust where he has retained a substantial control over the corpus and income of the trust. The Tax Court merely held that petitioners, as grantors of the trusts made for their wives and children, had not retained such a measure of control over the corpus and income of the trusts as to make the income of the trusts taxable to them (R. 332-342).

In contrast to the Tax Court cases, the issue joined in the case at bar was whether the trustees for petitioners' wives and children were, during the year 1941, bona fide partners of petitioners

within the meaning of the federal income tax laws (R. 20). The question whether petitioners had retained virtually complete control over the trusts, as distinguished from the partnership, was simply one factor of many that bore on the problem presented in this case. As such, it could not be deemed controlling. To place before the jury the Tax Court ruling on control of the trust would have given this factor undue emphasis, or, at least, it was within the discretion of the trial court so to determine (R. 145).

In *Commissioner* v. *Sunnen,* 333 U. S. 591, 599, this Court, in distinguishing the doctrine of collateral estoppel from the doctrine of *res judicata,* and in delimiting the former, stated that collateral estoppel will not be applied where a different legal doctrine controls or where the facts in question are not the very same facts presented for determination in the prior adjudication. The precise situation envisaged by this Court in the *Sunnen* case, is present here. First, the legal doctrine emanating from the *Tower* and *Lusthaus* cases, as distinguished from that springing from the *Clifford* case, was dispositive of this controversy. And secondly, it can scarcely be denied that factual considerations necessary to establish substantial future control over a trust gift, would not be controlling on the issue whether a partnership arrangement is bona fide.

We submit that both of the courts below correctly applied to this case the principles of col-

lateral estoppel as announced by this Court in *Commissioner* v. *Sunnen, supra,* and that they committed no error in rejecting this contention of petitioners.

3. Petitioners' assertion (Pet. 17) that the trial court erred in excluding certain evidence relating to their income taxes for prior years, which was offered to show their good faith during 1941, is without substance. The evidence which petitioners offered consisted of a number of letters written to them by the Internal Revenue Agent in Charge, Greensboro, North Carolina, in relation to their 1938 and 1939 income tax returns (Exhibits 26 to 26E, R. 48-49, 246-253). These letters advised petitioners generally that their income tax returns (both individual and partnership) for the tax years 1938 and 1939 had been examined and had been found to be correct or substantially correct, subject to readjustment should further information be received which would warrant such action. Petitioners offered these letters for the limited purpose of showing the good faith of the parties in continuing the operation of the business as a partnership during the calendar year 1941 (R. 48). The trial court excluded the letters because they did not relate to the tax years involved in the instant case, and for the further reason that the Internal Revenue Agent could not bind the Commissioner (R. 48, 157). Moreover, such bearing as the letters had on the good faith of peti-

tioners either in creating or in continuing the partnership during 1941, was remote in the ex- extreme. Consequently, there was no error in excluding the letters.

4. Petitioners also assert (Pet. 18) that the trial court's instruction to the jury (R. 183-184) concerning the presumption of correctness which attaches to the Commissioners' assessment of income taxes had the effect of giving the presumption the status of evidence to be weighed in determining the preponderance of the evidence. The instruction complained of reasonably states the rule that the presumption attaching to the Commissioner's assessment is *prima facie* only; that it may be attacked; that it remains effective only until challenged and overcome, and that it may be overcome by a preponderance of the evidence. The instruction plainly did no more than advise the jury that before they could hold for petitioners they must be satisfied by a preponderance of the evidence that the Commissioner's assessment of the taxes on the basis that the partnership was not bona fide, was without foundation in fact. Moreover, the trial court had but a moment before explicitly stated to the jury the scope of the presumption (R. 182). The instruction did not, therefore, give the presumption the character of evidence to be weighed as such.

Petitioners further contend that the trial court's definition of the term "business purpose" (R. 186)

in its charge to the jury had the effect of making origin of capital a complete test of the existence of a partnership for income tax purposes. This argument is likewise without merit. The trial court's definition cannot reasonably be read to convey any such strained connotation, and nothing in the charge suggests that benefit to the "business itself" is more than one factor to be considered among all the others. Cf. Pet. 18-19.

Finally, petitioners urge that the trial court throughout its charge to the jury overemphasized the tax-saving motive of petitioners for creating the partnership to the extent that it became an objective test of the validity of the partnership. The charge to the jury covers more than thirty pages of the record (R. 159-193, 197-200) and is replete with instructions that the jury might consider the various factors pointed out by this Court in the *Culbertson* case, as well as all the facts and circumstances, in determining whether the partnership was bona fide. We submit that the trial court did not magnify or unfairly stress the tax-saving motive in its charge to the jury. When read as a whole, the charge was, we believe, eminently fair to petitioners.

CONCLUSION

The decision of the court below, which rests on the particular facts of the case, is plainly correct, and there is no conflict of decisions. The petition for a writ of certiorari, therefore, should be denied.

Respectfully submitted,

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NOVEMBER, 1950.

☆ U.S. GOVERNMENT PRINTING OFFICE 1950—916929/P.O. 336

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 375

THOMAS M. STANBACK AND FRED J. STANBACK,
Petitioners,

vs.

CHARLES H. ROBERTSON, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF NORTH CAROLINA,
Respondent

REPLY BRIEF OF PETITIONERS

Questions Presented

The petitioners do not accept the statement of issues in the brief of the respondent for the reason that the statement of the respondent is an oversimplification which fails to state the substance of the issue at all as in paragraphs 3 and 4, or states only a part of the issue as in paragraph 2, or is misleading as in paragraph 1 in view of the fact that the contentions of the petitioner arise upon a motion for a directed verdict. It is submitted that the questions presented are correctly and fairly stated on page 2 of the petition for certiorari.

Reasons for Granting the Writ

1. *Res Judicata*

(a) *As to the whole cause of action*

The respondent's reply to this division of the petition for certiorari is based primarily upon the contention that the issue in the 1944 cases and in the case at bar were different.

The decision of any issue may be a collateral estoppel where it is necessary for the decision of the court, even though the whole issue in the two cases may not be identical. For instance, the redetermination of a deficiency in ordinary income taxes which necessitates computation of the amount of excess profits taxes to be deducted will be *res judicata* as to the correct amount of excess profits taxes. *Superheater Company* v. *Commissioner*, 125 F. 2d 514 (CCA 2).

The inquiry under the *Clifford-Horst* line of cases is whether the transaction under examination has "reality". The inquiry in 1944 as to whether the trusts lacked the requisite reality for tax purposes involved all the facts relating to the trusts and the partnership, including every element of ownership and control. Whether the inquiry is stated in terms of control and ownership, or of original or donated capital and intent to do business as a partnership, it is still the same. The rule of collateral estoppel does not depend upon alternative statements of the same issue. As early as 1945 the Tax Court held in at least one case that the government could not split the issue where the facts involved trusts and a family partnership, *Morris Eisenberg*, 5 T. C. 856, but even if the issue could have been so divided, the government had the election in 1943 when the Stanback cases were begun, and in 1944 when they were decided, to

attack the partnership alone as it had already done in the *Tower* and *Lusthaus* cases which were then pending and were actually decided several months before the Stanback cases, or it could have attacked the trusts in their entirety, as it did, using the facts of the partnership to support its contentions.

In either case the inquiry is the same. The fact that the government selected the trusts as the focal point of attack in 1944 should not relieve it of the consequence of the earlier determination nor permit it now to try the same issue on the same facts by the device of selecting a new focal point which was actually involved in and formed a part of the earlier inquiry. A contrary ruling will have the effect of giving the government two opportunities to impose taxes on the same theory and under the same section of the Internal Revenue Code, where the taxpayer will have only one to defeat an assessment.

(b) *As to ownership of partnership capital*

It is significant that the respondent makes no attempt to reply to this division of the petition for certiorari.

We wish to emphasize the fact that the Trustees of the trusts were held by the prior decisions to be the owners of the partnership capital, not in any ordinary or popular sense, but in the technical sense of the *Clifford-Horst* line of cases. Since that is true, it could not be ignored in the determination of the issue. When considered together with the other facts of the case, it is submitted that the petitioners were entitled to a direct verdict in their favor, but even if it did not go so far, it was certainly evidence which both the court and the jury were required to consider. The record in the Tax Court and its judgment were offered generally in evidence (R. 144-145). The point here made was expressly argued in the original brief of the petitioners

in the Court of Appeals (pp. 18-19, 34), and in their reply brief (pp. 4-5). Certified copies of these briefs have been filed with the Clerk, but they are not printed in the record.

2. *Recognition of the Partnership as a Matter of Law*

The petition for certiorari was filed in this case on October 23, 1950. At that time the decision of the Tax Court of the United States in *Theodore D. Stern,* 15 T. C. No. 71 (10-18-50), was not available.

It is submitted that the decision in that case and the decision of the Tax Court in *Herman Feldman,* 14 T. C. 17 (1-11-50) completely support all of the contentions of the petitioners made in the petition for certiorari relating to the existing conflict of attitude and of decision which entitled the petitioners to a review of their cases.

Both of the cases involved family partnerships based upon gifts by the taxpayers of capital interests held by Trustees as limited partners. The *Feldman* case, which involved a taxpayer residing in the Fourth Circuit, was decided upon the authority of *Economos* v. *Commissioner,* 167 F. 2d 165 (CCA 4), which is relied upon by the Court of Appeals for the Fourth Circuit in its decision in the Stanback cases (R. 349). The *Stern* case involved a taxpayer residing in the Seventh Circuit, and the decision is based upon *Greenberger* v. *Commissioner,* 177 F. 2d 990 (CA 7). In the *Stern* case the taxpayer was the owner of the overwhelming majority of 843 shares of the capital stock of a corporation which was engaged in the business of furnishing hotels, hospitals and other institutions with supplies of draperies, linens, furniture and other supplies. Other stockholders owned 85 shares. The taxpayer desired to encourage his sons to enter business with him, but in 1942 one of them was in military service, then twenty-five years of age. The second son who was twenty years old, was in

college, and the third son, who was sixteen years old, was in high school. The petitioner made gifts of 670 shares of stock to four trusts for his wife and his three sons, and the corpus of the trusts was distributable to the sons at the ages of twenty-one, twenty-six, thirty-one, and thirty-six. We direct attention to this fact, because one of the sons was already more than twenty-one years of age, and the grantor chose trusts for his sons so as to prevent the gifts from getting into the hands of a son's widow if he should be killed while he was in the service. The trusts were created on November 6, 1942. The corporation was dissolved on November 7, 1942 and a limited partnership was organized under date of November 10, 1942 for a period of ten years and thereafter from year to year. The purpose for changing from a corporation to a partnership was the avoidance of excess profits taxes, and personal income tax saving was one of the motives for the gifts. The net worth of the corporation is not greatly different from the net worth involved in the Stanback cases or in the *Feldman* case.

In the *Stern* case the partnership was upheld. In the *Feldman* case it was held invalid.

It is impossible within the limits desired by the Court to point out in detail the facts of the Stanback cases, the *Feldman* case and the *Stern* case in relation to each other, but it is submitted that there is no distinction between them except that it is submitted that the facts in the Stanback case are far stronger than they are in either of the other two. For instance, one of the Trustees in the Stanback cases was a trust company of undoubted standing and reputation, which performed its duties independently and without domination. In fact it was shown, and the Tax Court pointed out in the 1944 decisions, that the corporate trustee had exercised sole control over investment of the partnership income. In the Stanback cases all of the income was

currently distributable and was actually distributed. In the Stanback cases the wives had complete control over the anual income from the partnership. In the Stanback cases the taxpayers could not increase their partnership interests. In the *Stern* case any partner could increase his capital interest and share in the profits in proportion to the increased contribution, by which device the taxpayer could have purchased a vastly larger interest in the partnership at a price which might have been far less than its actual value. This point is completely ignored in the *Stern* case.

Space does not permit the elaboration of this argument. The cases relied upon by the petitioners as showing differences of fundamental attitude and a conflict of circuits are not cases in which there have been nothing more than variations in findings of fact. Nearly all of them are cases in which the facts as found by the Tax Court are accepted, and the Court of Appeals holds that there was no substantial evidence to support a finding that there was not a valid partnership. These are cases of outright reversal. There are numerous other cases in which the Courts of Appeals have reversed the Tax Court and have sent the cases back for review and for new findings in the light of the *Culbertson* case. The existence of the conflict is not only apparent to some of the judges of the Tax Court (see dissenting opinion in the *Feldman* case, 14 T. C. at p. 28), but it is the subject of comment elsewhere. (See "Federal Tax Coordinator," Research Institute of America, Volume II, Section N-534 and N-534a).

The taxpayer in the *Stern* case resides in the Seventh Circuit. The taxpayer in the *Feldman* case resides in the Fourth Circuit. As we have pointed out, the decision in the *Stern* case is based upon a decision of the Court of Appeals for the Seventh Circuit while the *Feldman* case is based upon a decision of the Court of Appeals for the

Fourth Circuit which are alleged by the petitioners in the case at bar to be in conflict. In view of the obvious conflict between the decisions of the Tax Court in the *Feldman* and *Stern* cases, we refer again to the suggestion made in the case of *Willis H. Vance,* 14 T. C. No. 132 (6-15-50), that decisions of the Tax Court may be seriously influenced by the decisions of a particular Court of Appeals to which an appeal may be taken. In any event the decisions in the cases cited and discussed both in the original petition and in this brief demonstrate that further clarification of the *Culbertson* case is required in order to produce uniform treatment of taxpayers in all parts of the United States and uniform protection of federal revenue, and such clarification is particularly imperative in those cases which involve, as in the Stanback cases, the ownership of capital interests only in partnerships. The number of cases involving both trusts and limited partnership interests are now so numerous as to indicate clearly that there is no uniformity of decision, and that the questions involved in the case at bar are sufficiently important to justify a review by this Court.

4. *Errors in the Charge to the Jury*

We do not wish the Court to gain the impression that the petitioners regard the errors in the charge to the jury as unimportant. It is submitted that they are so obvious that they do not require any discussion in addition to that on pages 18-20 of the original petition except to point out that, if the petitioners were not entitled to a direct verdict in the Court below for any of the reasons assigned, they were at least entitled to a fair trial under the principles declared in the *Culbertson* case.

It is submitted that the trial court did not make at any time in his own words a full and fair statement of the contentions of the petitioners. The statement of the peti-

tioners' contentions was embodied in written requests for instructions which were read by the Judge to the jury. Therefore, the petitioners were subjected to the disadvantage which arises from the reading of the written word as against the delivery of the spoken word. It is submitted that this fact should be measured in determining whether or not the charge was prejudicial.

Attention is also directed to the fact that immediately following the reading of the plaintiff's requests for instructions and at the beginning of the Defendant's Request No. 2 (R. 183) the Court says that the answer to the issue "is whether, under instructions which *I shall give you*" (italics supplied) the Commissioner erred in his determination. He then proceeds immediately to give the Commissioner's determination the status of evidence, which is directly contrary to several decisions of other Courts of Appeals. See page 18 of the original petition. The Court then reads, without application to the evidence, a series of conclusions largely quoted from earlier decisions of the Court of Appeals for the Fourth Circuit which could be of no use whatsoever to the jury in arriving at a correct verdict, but stated those conclusions in such form as to amount substantially to an instruction to disregard the contentions to the petitioners.

Among the instructions which the Court told the jury "I shall give you" is a completely erroneous definition of business purpose, directly in conflict with the decision of the Court of Appeals for the Sixth Circuit in *Miller* v. *Commissioner,* 183 F. 2d 246, (quoted on pages 18 and 19 of the petition herein), which was given in such manner as to amount to the direction of a verdict in favor of the Collector.

The Court then committed the further error of making intent to avoid or reduce taxes an objective test of the

validity of the partnership. In fact, he made a motive for tax avoidance the alternative of the issue. The closing part of the charge, given in the Court's own words, was devoted almost entirely to that thesis.

In filing the petition for certiorari we have insisted only upon those errors in the charge which appear to us to be particularly flagrant and highly prejudicial.

Respectively submitted,

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